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Banking Development after Nationalization and Social Control in India (1967 To 1991)

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Abstract: This paper mainly analyses the impact of Nationalisation and Social Control on Banking Sector till Economic Reforms. Social control was necessary to provide proper guidelines for bank management. The objective was to serve better the needs of development of the economy in conformity with national policy objectives. It was believed that the objectives and policies of the nations could be achieved through nationalisation. It was also felt that bank deposits could be used for the economic development of the country as a whole rather than for certain industries and business houses. After nationalisation in 1969 major structural transformation had occurred in the Indian banking system. LBS became the principal instrument for branch expansion. Spread of banking and deposit mobilisation were the two most significant achievements of nationalisation.
Key Words: Social Control, Nationalisation, Lead Bank Scheme, Weaker Sections, Differential Rate of Interest.

I. INTRODUCTION

The main objectives of social control was to spread the bank credit, prevent its misuse, direct larger volume of credit flow to priority sectors and to make it more effective instrument of economic development. Social control was necessary to provide proper guidelines for bank management. It was felt that a purposeful and equitable distribution of credit should be ensured with the help of periodical assessment of the demand for bank credit, determination of priorities for lending and investment amongst various sectors of the economy and adequate follow-up of these by the banking system. It was expected that such a step would ensure a better alignment of the banking system with the needs of economic policy. The National Credit Council (NCC) was set up in February 1968 to assist the Reserve Bank and the Government to allocate credit according to plan priorities. It was entrusted with the task of (i) estimating the demand for bank credit from the different sectors of the economy; and (ii) fixing priorities for grant of loans or for investment after taking into account the availability of resources, and needs of the priority sectors, especially agriculture, small scale industries and exports. The council worked towards bringing about an optimum utilisation of resources by coordinating the lending and investment policy of commercial banks, co-operative banks and other specialised institutions. In terms of the recommendations of the National Credit Council, the Banking Regulation Act was amended on February 1, 1969 in order to enable the appointments of directors with specialised knowledge or practical experience in the fields of agriculture, small scale industry and rural economy, as members of the boards of directors of commercial banks with the approval of the Reserve Bank. Despite the system of social control on banks, a large segment of the population remained outside the purview of the organised sector credit.

A. Nationalisation of Banks and Spread of Banking

Inspite of the fact that banking system had made some progress in terms of deposit growth in the 1950s and the 1960s; its spread was mainly concentrated in the urban areas. The progress regarding the social objectives was not adequate. A notable feature of Indian commercial banking was the control of the major banks by leaders of commerce and industry. Banks were run to satisfy their requirements rather than to work according to commercial principles. The result was the gradual erosion in the capital base of banks. The ratio of paid-up capital and reserves to deposits declined by more than 75 per cent from 9.7 per cent in 1951 to 2.2 per cent in 1969[1]. The rapid increase in deposits in relation to their owned capital enabled the industrialist shareholders to enjoy immense leverage. It was felt that if bank funds had to be channeled for rapid economic growth with social justice, there was no alternative to nationalisation of at least the major segment of the banking system. Accordingly, the Government nationalised 14 banks with deposits of over Rs.50 crore by promulgating the Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969. These banks were the Central Bank of India, Bank of Maharashtra, Dena Bank, Punjab National Bank, Syndicate Bank, Canara Bank, Indian Overseas Bank, Indian Bank, Bank of Baroda, Union Bank, Allahabad Bank, United Bank of India, UCO Bank and Bank of India. The objective was to serve better the needs of development of the economy in conformity with national policy objectives. It was believed that the objectives and policies of the nations could be achieved through nationalisation. It was also felt that bank deposits could be used for the economic development of the country as a whole rather than for certain industries and business houses. Thus, the tasks was set for the nationalised banks were to mobilise the deposits on a large scale and to lend those funds for all productive activities, and to weaker sections of the society, irrespective of the size and social status of the borrower . On the eve of nationalisation, the banks had a definite urban orientation as about 44 per cent of total deposits and 60 per cent of total credit were accounted for by the five centres. (Table 1.7)

Table 1.7: Share of Major Cities in Total Deposits and Credit of Banks: End December 1969

City	No of Offices	Deposits		Credit		C-D Ratio
		Amount (Rs crore)	% share in total	Amount (Rs crore)	% share in total	
1	2	3	4	5	6	7
Ahmedabad	119	117	22	117	3.1	100.6
Bombay	456	964	14.6	976	26.2	101.3
Calcutta	258	573	11	694	18.6	121.1
Delhi	296	493	9.5	200	5.4	40.6
Madras	178	140	2.7	248	6.6	175.8
Total	1307	2287	40.2	2235	59.9	97.7
All India	9007	5173	100	3729	119.8	72.1

Note: Cities with population of over 10,00,000 according to 1961 Census.
C-D Ratio represents Credit Deposit Ratio
Source: Statistical Tables Relating to Banks in India, 1969.

After nationalisation in 1969 major structural transformation had occurred in the Indian banking system. Specific emphasis was laid down on making banking facilities available in unbanked areas. This was executed through two definite steps that by designing a specific branch license policy and by initiating specific schemes like the Lead Bank Scheme (LBS). LBS was launched by the Reserve Bank of India with a view to mobilise the deposits on a large scale throughout the country and to provide credit to weaker sections of the economy, LBS became the principal instrument for branch expansion. The 'lead bank' designated for the district was also responsible for taking lead role in surveying the credit needs of the population, development of banking and of credit facilities in the district allotted to it. Initially, all the districts of the country (barring metropolitan cities and the union territories) were allotted to 22 public sector banks (SBI and its 7 associates banks and 14 nationalised banks) and three private sector banks (Andhra Bank Ltd., Bank of Rajasthan Ltd. and Punjab and Sind Bank Ltd.).The resource base of the bank concerned and regional orientation of banks were taken into consideration for allotting districts to the banks. Districts were allotted in clusters to facilitate control and in each state two or more than two banks were allotted the responsibility of districts. Each bank was also allotted districts in more than one State. The allotment of districts to various banks under the LBS had a major role in the spread of banking to unbanked centres. In about 5 years after nationalisation of banks, the branch network expanded by 129 per cent.The population per bank office declined from 65,000 per bank office in June 1969 to 31,660 in December 1975. Of the 10,543 new branches opened, 5,364 (50.1 per cent) were in rural areas. As a result, the share of rural branches in total bank branches increased from 17.6 per cent in 1969 to 36.3 per cent in 1975. Banks spread out first to rural areas and then into unbanked areas. In 1977, banks were given the incentive of a license to open one branch in metropolitan and one in urban areas, as an incentive for opening four branches in rural areas. (Table 1.8)

Branch expansion continued in the 1980s. Regional distribution of bank branches also improved in the 1980s in comparison with the 1970s (Table 1.9). Branch expansion was more in rural centres. It was felt that the branch licensing policy alone could not address the issue of rural credit. In order to ensure that rural deposits were not used to just increase urban credit, banks were directed that each rural and semi-urban bank should maintain a credit-deposit ratio of at least 60 per cent. The credit-deposit ratios for the banks in rural and semi-urban branches were carefully monitored. To accelerate the process of development, the nationalisation of banks also led to reorientation of bank lending, especially of the priority sectors of the economy, which had not initially received sufficient attention from the commercial banks.

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As at end	Rural Centre	Semi-urban Centre	Urban Centre	Metropolitan Centre/Port Towns	Total	Population Per Bank office
1	2	3	4	5	6	7
Jun-69	1443 (17.6)	3,337 (40.8)	1,911(23.3)	1,496 (18.3)	8187	65000
Dec-75	6807(36.3	5598(29.9)	3489(18.6)	2836(15.1)	18730	31,660
Dec-80	15105(46.6)	8122 (25.05)	5178 (16.0)	4014(12.4)	32419	20,481
Dec-85	30185(58.7)	9816(19.1)	6578 (12.8)	4806 (9.4)	51,385	14,381
Dec-90	34791(58.2)	11324 (19.0)	8042 (13.5)	5595 (9.4)	59,752	13,756

Table 1.8: Branch Networks of Commercial Banks

Note: Figures in brackets are percentage shares in total.
Source: GOI, Banking Statistics 1972 for data for the year 1959 & Handbook of Statistics on Indian Economy 2006-07 for other years, RBI

Table 1.9: Region wise Distribution of Bank Branches in India

As at End	Northern	North Eastern	Eastern	Central	Western	Southern	Total
1	2	3	4	5	6	7	8
Jun 75	3174 (17.1)	275 (15)	2189 (11.8)	2795 (15)	3873 (20.9)	6269 (33.7)	18,575 (100)
Jun 80	5409 (16.7)	703 (2.2)	4778 (14.7)	5588 (17.2)	5790 (17.9)	10,144 (31.3)	32,412 (100)
Jun 85	8239 (15.7)	1363 (2.6)	8987 (17)	10,935 (20.8)	8259 (15.7)	14,855 (28.2)	52,638 (100)
Mar 90	9312 (15.4)	1772 (2.9)	10,879 (18)	12,747 (21)	9417 (15.6)	16388 (27.1)	60,515 (100)
Mar 91	9426 (15.3)	1870 (3.0)	11,362 (18.4)	13,005 (21.1)	9526 (15.4)	16535 (26.8)	61724 (100)

Note: Figures within parentheses represent the percentage share in total
Northern Region: Haryana, Himachal Pradesh, Jammu & Kashmir, Punjab, Rajasthan, Chandigarh, Delhi
North Eastern Region: Assam, Meghalaya, Manipur, Nagaland, Tripura, Arunachal Pradesh, Mizoram
Eastern Region: Bihar, Orissa, West Bengal, Andaman and Nicobar Island
Central Region: Madhya Pradesh, Uttar Pradesh
Western Region: Gujarat, Maharashtra, Goa, Daman and Diu, Dadra and Nagar haveli
Southern Region: Andhra Pradesh, Kerala, Karnataka, Tamil Nadu, Puducherry , Lakshadweep
Source: Basic Statistical Returns, Various issues

After planned economic development in India, particularly in the 1960s, a high degree of emphasis was placed on deposit mobilisation by banks as one of the main ways through which the resources for the development of the economy could be enlarged. Efforts were made to keep the deposit rates attractive. The period of nationalisation was coincided with the period of the Green Revolution and its benefits started flowing to the rural sector in terms of higher income. Rapid expansion of the branch network in rural areas, special emphasis on deposit mobilisation and rise in income levels increased the growth of bank deposits. *Spread of banking and deposit mobilisation were the two most significant achievements of nationalisation.*[2]

Table 1.10: Average Annual Growth Rates of Deposits in Scheduled Commercial Banks (percent)

Period	Growth rate of Demand Deposits	Growth rate of Time Deposits	Growth rate of Aggregate Deposits
1	2	3	4
1960-65	15.1	7	11.05
1965-70	12.6	15.8	14.2
1970-75	17.3	19.7	18.5
1975-80	8.1	30.6	19.35

Source: RBI, Handbook of Statistics on the Indian Economy, 2006-07

B. Institution of Directed Credit and the Setting Up of Regional Rural Banks

A major tool of development policy in both developed and developing countries in the 1960s was directed credit programme which involves loans on preferential terms and conditions to priority sectors. The need to channel the flow of credit to certain sectors of the economy, known as the priority sectors with the social objectives in mind, was first discussed in India in July 1961. The bulk of bank advances continued to be directed to large and established business houses, while agriculture, SSI and exports did not receive adequate attention. As a result, the need was felt for imposing lending stipulations. The severe imbalances had developed in the economy in agricultural output in 1965-66 and 1966-67, which had resulted in a shortfall in agricultural output and slowing down of industrial production. Thus the need to channel the flow of credit to certain sectors of the economy in the larger interests of the country could be traced to the slack season 1967. At a meeting of the National Credit Council held in July 1968, it was emphasised that commercial banks should increase their involvement in the financing of priority sectors i.e. agriculture and small scale industries. One of the objectives of nationalisation of banks was also to ensure that no productive endeavour fell short of credit support. Beginning the early 1970s, banking policy was used as an active instrument of growth and for securing a progressive reduction in inequalities in income, concentration of economic power and regional disparities in banking facilities. A major reason for the intervention of the policy was that some sections could not obtain credit and afford market rates of interest and should, therefore, be provided credit on a preferential basis at concessional rates of interest. As a result, the promotional aspects of banking policy came into greater prominence. The definition of the priority sector was formalised in the 1972, although initially there were no specific targets in priority sector lending. However, in November 1974, public sector banks were advised that their priority sector lending should reach a level of not less than one-third of the outstanding credit by March 1979. National targets for advances to priority sectors as a whole, with sub-targets for weaker sections of the society were laid down. In November 1978, private sector banks were also advised to maintain one-third of their total advances to the priority sectors by the end of March 1980. Subsequently, the target was enhanced to 40 per cent of aggregate advances. A larger proportion of the banking sector's funds went to larger borrowers leaving little for the smaller ones. In the case of scheduled commercial banks, for instance, 81 per cent of total borrowing accounts were for amounts up to Rs.10, 000, but they accounted for less than 4 per cent of bank credit. In order to correct for this situation, two measures were taken. First, special emphasis was laid on the economic upliftment of the weaker sections of society in rural areas by stipulating specific targets (10 per cent within the overall target). Second, to mitigate the default risk the Reserve Bank promoted the establishment of the Credit Guarantee Corporation of India Ltd. In 1971 for providing guarantees against the risk of default in payment. This policy encouraged the commercial banks and other institutions to grant loans to various categories of small borrowers. At a broader level, given that the incidence of poverty and lack of access to credit was more in the remote unbanked areas, the branch expansion policy was designed to reduce inter-regional disparities in deployment of credit. The Differential Rate of Interest (DRI) Scheme was also instituted in 1972 to cater to the needs of the weaker sections of the society and for their upliftment. The scheme targeted low income people in rural areas and gave them credit at concessional rate. The target group of this scheme was landless labourers, physically handicapped persons, orphanages, women's homes, scheduled castes and scheduled tribes who did not have any tangible security to offer and to the lending institutions. The minimum quantum of lending under this scheme for each bank was one per cent of its total advances of the previous year. The major problem faced by banks in administering this scheme as agents of the Government was proper identification of beneficiaries from among a large number of eligible borrowers so that the weakest among the eligible borrowers could benefit from the scheme. Various measures initiated had a positive impact on lending to agriculture as the share of agricultural credit in total bank credit increased from 2.2 per cent in 1967 to 8.0 per cent in 1970-71 and further to 9.1 per cent in 1974-75. However, the improvement fell short of expectations. (Table 1.11) It was realised that commercial banks were not tuned to the needs and requirements of small and marginal farmers, while the co-operatives lacked resources to meet the expected demand hence, the idea of starting rural banks was first suggested by the Banking Commission (1972), action along these lines was initiated after the 'Twenty Point Programme' or 'New Economic Programme' of the Government of India launched in the mid-1970s. The Regional Rural Banks ordinance was promulgated on September 26, 1975, which was subsequently replaced by the Regional Rural Banks Act on February 9, 1976.

Table 1.11: Scheduled Commercial Banks Advances to Agriculture

Year April-March	Direct Finance to Agriculture		Indirect finance to Agriculture		Total Direct and Indirect Finance to Agriculture		Bank Credit
	Amount (Rs crore)	Share in Total %	Amount (Rs crore)	Share in Total %	Amount (Rs crore)	Share in Total %	(Rs crore)
1	2	3	4	5	6	7	8
1966-67	-	-	-	-	57#	2.2#	2717
1970-71	235	5	143	3	378	8	4684
1971-72	259	4.9	135	2.6	394	7.5	5263
1972-73	313	5.1	172	2.9	485	7.9	6115
1973-74	418	5.7	197	2.7	615	8.3	7399
1974-75	543	6.2	255	2.9	798	9.1	8762

Note: Break-up on direct and indirect finance to agriculture not available in 1966-67.
Source: 1.RBI, Handbook of Statistics on the Indian Economy, 2006-07
2. RBI, Report on Trend and Progress of Banking in India, 1967-68

Regional Rural Banks (RRBs) were set up with a view to developing the rural economy by providing credit for the purpose of development of agriculture, trade, commerce, industry and other facilities, particularly to the small and marginal farmers, agricultural labourers, artisans and small entrepreneurs. They were expected to ‘combine the rural touch and local feel with the modern business organisation’. The Differential Rate of Interest (DRI) Scheme was modified to allow sponsor banks to route the DRI advances through RRBs on a refinance basis, in addition to the routing of such advances on an agency basis. The refinance to RRBs carried a rate of interest at 2 per cent per annum and the amount of refinance so provided was taken into account by sponsoring banks for the purpose of the target of 1 per cent of the lending under the scheme. On the whole, scheduled commercial banks’ advances to agriculture, exports and small scale industries showed a significant rise, while those to industry declined. (Table 1.12)

Table 1.12: Distribution of Bank Credit to Various Sectors-outstanding (Rs crore)

As at End	Industry	Small Scale Industry	Exports	Agriculture	Gross Bank Credit
1	2	3	4	5	6
Mar-68	1441 (67.5)	-	-	47 (2.2)	2135 (100)
Mar-80	8260 (38.9)	2633 (12.4)	1635 (7.7)	2760.55(13.0)	21235 (100)
Jun-89	33621(37.5)	13717(15.3)	6545 (7.3)	14165.33(15.8)	89654 (100)

Note: Figures in Parentheses are percentage shares in total
Source: RBI, Report on Trend and Progress of Banking in India, various issues.

C. Nationalisation of Banks in 1980

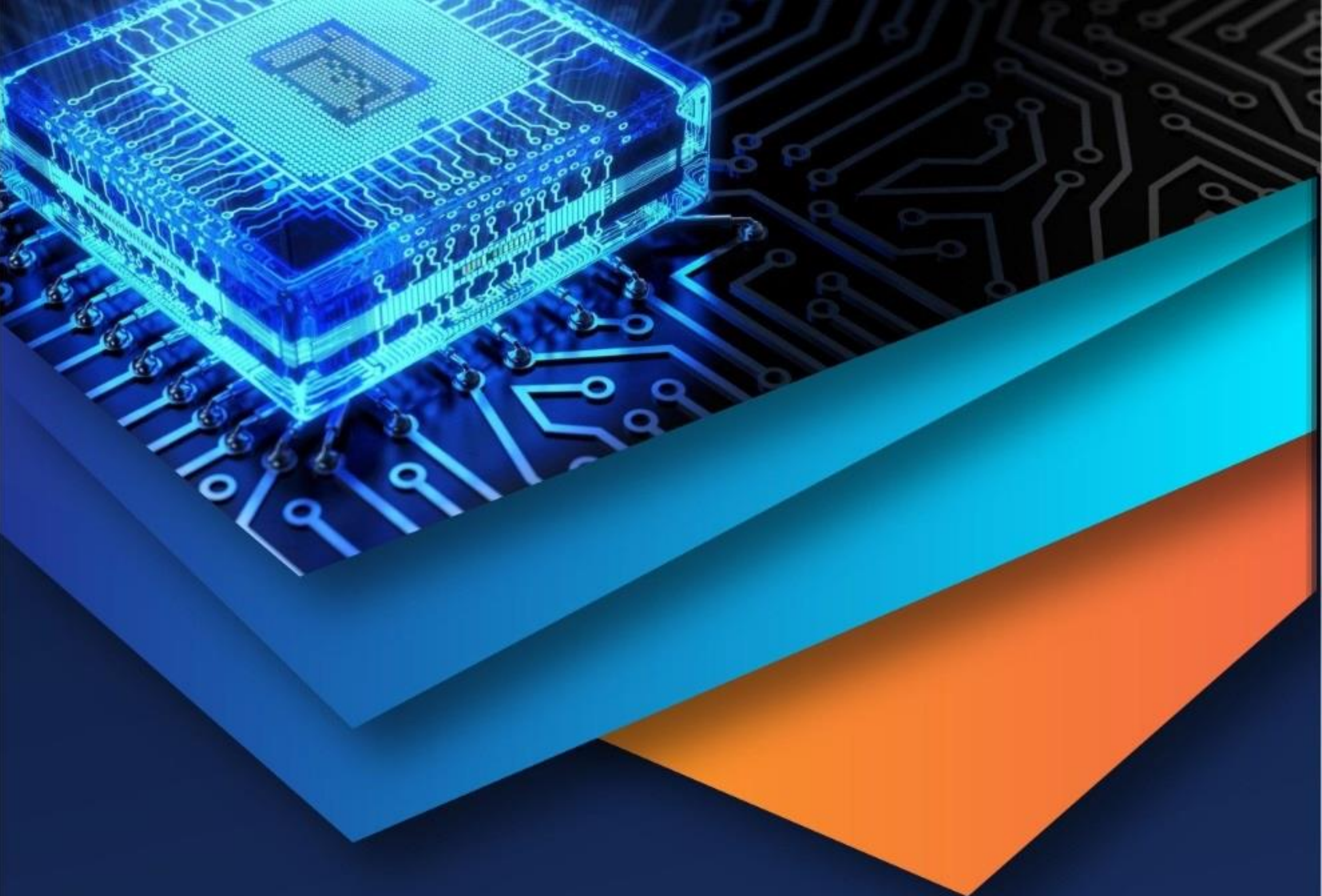
The need of credit delivery in greater measure and some governance problems of private banks created the need for nationalisation of six more banks i.e. Andhra Bank, Corporation Bank, New Bank of India, Oriental Bank of Commerce, Punjab and Sind Bank, and Vijaya Bank with deposit liabilities of Rs.200 crore and above, were nationalised in April 1980. With the nationalisation of these six banks by the Government, the number of public sector banks, including the State Bank of India and its associate banks rose to 28 in April 1980, constituting 91 per cent deposits of the banking sector. Large branch expansion resulted in increase in deposits and credit of the banking system from 13 and 10 per cent of GDP, respectively, in 1969 to 38 per cent and 24 per cent, respectively, by 1991. The evidence suggested that the incremental deposits were largely from the branches opened after 1969. The share of rural deposits in total deposits increased from 3 per cent in 1969 to 16 per cent in 1990. The share of credit to the rural sector in total bank credit increased from 3.3 per cent in 1969 to 14.2 per cent in 1990. The credit needs of the economy was met by the banking sector by rendered support to the planning authority and efficient and productive deployment of investible funds so as to maximize growth with stability and social justice.

II. CONCLUSION

Major issues faced at the beginning of this phase were the strong relation between banks and industry, as a result of which agriculture was ignored. The focus in this phase was to break the nexus and improve the flow of credit to agriculture. The main instruments used for this purpose were nationalisation of major banks in the country and institution of directed credit in the form of priority sector lending. The achievements during the nationalisation phase were extensive, varied and widely acknowledged. The nationalisation of banks in 1969 and again in 1980 brought a large segment of the banking business under government ownership. In the post-nationalisation phase, the country was able to build up financial infrastructure, geographically wide and financially diverse to accelerate the process of resource mobilisation to meet the growing needs of the economy. The nationalisation of banks in 1969 was a major step to ensure timely and adequate credit to all the productive activities of the economy. It was designed to make the system reach out to the small man and the rural and semi-urban areas and to extend credit coverage to sectors then neglected by the banking system.

NOTES AND REFERENCES

[1] Banking Commission 1971, page 38.
[2] Report on currency and Finance, 2008-09.



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